

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Year Ended September 30,		
	2008	2007	2006
Net sales	\$564,602	\$581,371	\$602,744
Cost of goods sold	281,561	281,155	288,082
Gross profit	283,041	300,216	314,662
Selling, general and administrative expenses	271,592	279,719	279,713
Store closing, asset impairment and asset disposal expenses	2,916	1,788	4,621
Restructuring and other charges	3,461	—	—
Operating income	5,072	18,709	30,328
Interest expense, net	6,974	9,848	14,534
Loss on extinguishment of debt	97	9,423	873
Income (loss) before income taxes	(1,999)	(562)	14,921
Income tax provision (benefit)	(610)	(169)	5,819
Net income (loss)	\$ (1,389)	\$ (393)	\$ 9,102
Net income (loss) per share—Basic	\$ (0.23)	\$ (0.07)	\$ 1.70
Average shares outstanding—Basic	5,924	5,802	5,348
Net income (loss) per share—Diluted	\$ (0.23)	\$ (0.07)	\$ 1.63
Average shares outstanding—Diluted	5,924	5,802	5,591

The accompanying notes are an integral part of these Consolidated Financial Statements.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
AND COMPREHENSIVE INCOME (LOSS)

(in thousands)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss		Comprehensive Income (Loss)
	Number of Shares	Amount			Total		
Balance as of September 30, 2005	5,269	\$ 53	\$ 63,164	\$ 111	\$ —	\$63,328	
Net income	—	—	—	9,102	—	9,102	\$ 9,102
Comprehensive income							\$ 9,102
Stock-based compensation	—	—	1,374	—	—	1,374	
Exercise of stock options	355	3	4,910	—	—	4,913	
Excess tax benefit from stock option exercises	—	—	1,983	—	—	1,983	
Balance as of September 30, 2006	5,624	56	71,431	9,213	—	80,700	
Net loss	—	—	—	(393)	—	(393)	\$ (393)
Initial prior service cost for retirement plans, net of tax	—	—	—	—	(1,202)	(1,202)	
Amortization of prior service cost for retirement plans, net of tax	—	—	—	—	126	126	126
Change in fair value of interest rate swap, net of tax	—	—	—	—	(325)	(325)	(325)
Unrealized loss on investments, net of tax	—	—	—	—	(3)	(3)	(3)
Comprehensive loss							\$ (595)
Stock-based compensation	121	1	2,100	—	—	2,101	
Exercise of stock options	218	3	3,734	—	—	3,737	
Excess tax benefit from stock option exercises	—	—	2,360	—	—	2,360	
Reclassification of equity award from liabilities	—	—	1,422	—	—	1,422	
Balance as of September 30, 2007	5,963	60	81,047	8,820	(1,404)	88,523	
Net loss	—	—	—	(1,389)	—	(1,389)	\$ (1,389)
Amortization of prior service cost for retirement plans, net of tax	—	—	—	—	192	192	192
Retirement plan amendment, net of tax	—	—	—	—	393	393	393
Change in fair value of interest rate swap, net of tax	—	—	—	—	(556)	(556)	(556)
Unrealized gain on investments, net of tax	—	—	—	—	3	3	3
Comprehensive loss							\$ (1,357)
Cumulative effect of adoption of FIN No. 48 (Note 13)	—	—	—	74	—	74	
Stock-based compensation	41	—	2,281	—	—	2,281	
Exercise of stock options	74	1	691	—	—	692	
Tax benefit shortfall from stock option exercises and restricted stock vesting	—	—	(627)	—	—	(627)	
Repurchase and retirement of common shares	(7)	—	(118)	—	—	(118)	
Balance as of September 30, 2008	6,071	\$ 61	\$ 83,274	\$ 7,505	\$ (1,372)	\$89,468	

The accompanying notes are an integral part of these Consolidated Financial Statements.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended September 30,		
	2008	2007	2006
Cash Flows from Operating Activities			
Net income (loss)	\$ (1,389)	\$ (393)	\$ 9,102
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	15,974	16,410	16,118
Stock-based compensation expense	2,281	2,101	2,796
Loss on impairment of long-lived assets	1,628	1,781	2,612
(Gain) loss on disposal of assets	546	(422)	(139)
Loss on extinguishment of debt	97	9,423	873
Accretion of discount on notes	—	89	186
Deferred income tax provision (benefit)	(969)	(3,067)	715
Amortization of deferred financing costs	246	437	689
Changes in assets and liabilities:			
Decrease (increase) in—			
Trade receivables	5,009	(463)	(3,950)
Inventories	12,429	(6,226)	11,652
Prepaid expenses and other current assets	(784)	1,788	(3,579)
Other non-current assets	247	(44)	13
Increase (decrease) in—			
Accounts payable, accrued expenses and other current liabilities	(14,702)	7,389	7,226
Deferred rent and other non-current liabilities	7,209	(1,405)	(1,901)
Net cash provided by operating activities	<u>27,822</u>	<u>27,398</u>	<u>42,413</u>
Cash Flows from Investing Activities			
Purchase of short-term investments	—	(19,550)	(97,555)
Proceeds from sale of short-term investments	—	28,975	88,130
Withdrawal from (contribution to) grantor trust	2,684	(2,662)	—
Capital expenditures	(15,688)	(15,444)	(13,933)
Proceeds from sale of property, plant and equipment	—	85	—
Proceeds from sale of assets held for sale	—	493	225
Purchase of intangible assets	(343)	(9)	(33)
Net cash used in investing activities	<u>(13,347)</u>	<u>(8,112)</u>	<u>(23,166)</u>
Cash Flows from Financing Activities			
Increase (decrease) in cash overdrafts	1,524	(584)	1,077
Proceeds from issuance of long-term debt	—	90,000	—
Repayment of long-term debt	(14,534)	(116,039)	(10,770)
Premium on repurchase of long-term debt	—	(6,469)	(583)
Deferred financing costs	(21)	(1,065)	—
Repurchase of common stock	(118)	—	—
Proceeds from exercise of stock options	692	3,737	4,913
Excess tax benefit from exercise of stock options	—	2,360	1,983
Net cash used in financing activities	<u>(12,457)</u>	<u>(28,060)</u>	<u>(3,380)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>2,018</u>	<u>(8,774)</u>	<u>15,867</u>
Cash and Cash Equivalents, Beginning of Year	<u>10,130</u>	<u>18,904</u>	<u>3,037</u>
Cash and Cash Equivalents, End of Year	<u>\$ 12,148</u>	<u>\$ 10,130</u>	<u>\$ 18,904</u>

The accompanying notes are an integral part of these Consolidated Financial Statements.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF BUSINESS

Destination Maternity Corporation (formerly Mothers Work, Inc.) and subsidiaries (the "Company") is a specialty designer and retailer of maternity clothing. On December 8, 2008, the Company changed its corporate name from "Mothers Work, Inc." to "Destination Maternity Corporation." The name change was accomplished through the merger of a newly-formed, wholly-owned subsidiary, DM Newco, Inc., into Mothers Work, Inc. The Company operated 1,032 retail locations as of September 30, 2008, including 754 stores and 278 leased departments, throughout the United States and Canada. In addition, the Company markets maternity apparel at Kohl's® stores throughout the United States under an exclusive product and license agreement. The Company was incorporated in Delaware in 1982.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its direct and indirect wholly-owned subsidiaries of Cave Springs, Inc., Mothers Work Canada, Inc., Maternity Factory Warehouse Centre, Inc. (a wholly-owned subsidiary of Mothers Work Canada, Inc.), Mothers Work Services, Inc. and Confecciones Acona S.A. All significant intercompany transactions and accounts have been eliminated in consolidation.

b. Fiscal Year-End

The Company operates on a fiscal year ending September 30 of each year. All references to fiscal years of the Company refer to the fiscal years ended on September 30 in those years. For example, the Company's "fiscal 2008" ended on September 30, 2008.

c. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make certain estimates and assumptions that may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

d. Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, cash in the bank and short-term investments with an original maturity of three months or less when purchased. Cash overdrafts of \$4,830,000 and \$3,306,000 were included in accounts payable as of September 30, 2008 and 2007, respectively.

The Company maintains cash accounts that, at times, may exceed federally insured limits. The Company has not experienced any losses from maintaining cash accounts in excess of such limits. Management believes that it is not exposed to any significant credit risks on its cash accounts.

e. Investments

The Company's investments may be classified as either held-to-maturity or available-for-sale. Held-to-maturity securities are carried at amortized cost and represent those securities that the Company has both the intent and ability to hold to maturity. Available-for-sale securities are carried at fair value and are classified as such because these securities are not actively traded and do not meet the classification of held-to-maturity. Interest on investments, as well as amortization of discounts and

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

premiums, is included in interest income. Unrealized gains and losses on available-for-sale securities are excluded from earnings and are reported as accumulated other comprehensive income (loss) until realized. When available-for-sale securities are sold, the cost of the securities is specifically identified and is used to determine the realized gain or loss.

f. Inventories

Inventories are valued at the lower of cost or market. Cost is determined by the "first-in, first-out" (FIFO) method. Inventories of goods manufactured by the Company include the cost of materials, freight, direct labor, and manufacturing and distribution overhead.

g. Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation and amortization are computed for financial reporting purposes on a straight-line basis, using service lives ranging principally from five to ten years for furniture and equipment and forty years for the building. Leasehold improvements are amortized using the straight-line method over the shorter of the lease term or their useful life. The cost of assets sold or retired and the related accumulated depreciation or amortization are removed from the accounts with any resulting gain or loss included in net income (loss). Maintenance and repairs are expensed as incurred except for the capitalization of major renewals and betterments that extend the life of the asset. Long-lived assets are reviewed for impairment whenever adverse events, or changes in circumstances or business climate indicate that the carrying value may not be recoverable. Factors used in the evaluation include, but are not limited to, management's plans for future operations, brand initiatives, recent operating results and projected cash flows. If the associated undiscounted cash flows are insufficient to support the recorded asset, an impairment loss is recognized to reduce the carrying value of the asset. The amount of the impairment loss is determined by comparing the discounted expected future cash flows with the carrying value.

During fiscal 2008, 2007 and 2006, the Company recorded impairment write-downs of property, plant and equipment totaling \$1,615,000, \$1,776,000 and \$2,578,000, respectively, on a pre-tax basis.

h. Goodwill and Intangible Assets

Goodwill represents the excess of cost over the fair value of net assets acquired in business combinations. Goodwill is reviewed for impairment at least annually or when events or changes in circumstances indicate the carrying value of the goodwill might exceed the fair value in accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." Management determined that the Company has one reporting unit for purposes of applying SFAS No.142 based on its reporting structure. The Company makes its assessment of impairment as of September 30 of each fiscal year. The fair value of the Company's single reporting unit at each measurement date is determined based on a combination of the fair market value of the Company's outstanding common stock on a control basis, a discounted cash flow analysis and other generally accepted valuation methodologies and, if necessary, an outside independent valuation is obtained to determine the fair value. As part of the Company's impairment analysis as of September 30, 2008, an outside independent valuation was obtained and the fair value of the Company's single reporting unit exceeded the carrying value.

Based on these assessments, no impairment loss was required to be recognized at any of the measurement dates. The Company plans to perform an annual assessment for goodwill impairment at

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

the end of each fiscal year or as impairment indicators arise. If the fair market value of the Company's outstanding common stock on a control basis were to significantly decline on an other than temporary basis, the goodwill would likely be impaired.

Intangible assets with definite useful lives, which primarily consist of lease acquisition costs and patents, are amortized over the shorter of their useful life or, if applicable, the lease term. Management reviews the carrying amount of these intangible assets as impairment indicators arise, to assess the continued recoverability based on future undiscounted cash flows and operating results from the related asset, future asset utilization and changes in market conditions. During fiscal 2008, 2007 and 2006, the Company recorded write-downs of intangible assets totaling \$13,000, \$5,000 and \$34,000, respectively, on a pre-tax basis. The Company has not identified any indefinite-lived intangible assets. Aggregate amortization expense of intangible assets in fiscal 2008, 2007 and 2006 was \$119,000, \$153,000 and \$199,000, respectively.

Estimated amortization expense for the next five fiscal years is as follows (in thousands):

<u>Fiscal Year</u>		
	2009	\$133
	2010	83
	2011	70
	2012	62
	2013	55

i. Interest Rate Derivatives

The Company mitigates a portion of its floating rate interest risk on variable rate long-term debt through an interest rate swap agreement. In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," the Company recognizes the derivative on the balance sheet at fair value. On the date the derivative instrument was entered into the Company designated it as a hedge of the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"). Changes in the fair value of a derivative that is designated as, and meets all the criteria for, a cash flow hedge are recorded in accumulated other comprehensive income (loss) and reclassified into earnings as the underlying hedged item affects earnings. The Company formally documents the relationship between hedging instruments and hedged items. The Company also formally assesses at the inception of the hedge and on a quarterly basis, whether the derivative is highly effective in offsetting changes in cash flows of the hedged item. Any portion of the change in fair value of the derivative associated with hedge ineffectiveness is included in current earnings. As of September 30, 2008 and for the year then ended, the Company's interest rate swap was determined to have no ineffectiveness.

j. Deferred Financing Costs

Deferred financing costs (see Note 9) are amortized to interest expense over the term of the related debt agreement. Amortization expense of deferred financing costs in fiscal 2008, 2007 and 2006 was \$246,000, \$437,000 and \$689,000, respectively. In connection with debt extinguishments, in fiscal 2008, 2007 and 2006 the Company wrote off \$97,000, \$2,173,000 and \$213,000 of unamortized deferred financing costs (see Note 9).

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Estimated amortization expense of deferred financing costs for the next five fiscal years is as follows (in thousands):

<u>Fiscal Year</u>		
2009	\$236	
2010	235	
2011	234	
2012	168	
2013	56	

k. Deferred Rent

Rent expense on operating leases, including rent holidays and scheduled rent increases, is recorded on a straight-line basis over the term of the lease commencing on the date the Company takes possession of the leased property, which is generally four to six weeks prior to a store's opening date. The net excess of rent expense over the actual cash paid has been recorded as deferred rent in the accompanying Consolidated Balance Sheets. Tenant improvement allowances received from landlords are also included in the accompanying Consolidated Balance Sheets as deferred rent liabilities and are amortized as a reduction of rent expense over the term of the lease from the possession date.

l. Treasury (Reacquired) Shares

Shares repurchased are retired and treated as authorized but unissued shares, with the cost in excess of par value of the reacquired shares charged to additional paid-in capital and the par value charged to common stock.

m. Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, investments, trade receivables and accounts payable approximate fair value due to the short-term nature of those instruments. A substantial portion of the Company's long-term debt bears interest at variable rates, which adjust based on market conditions and the carrying value of the long-term debt approximates fair value. A portion of the Company's floating rate interest risk on variable rate long-term debt is mitigated through an interest rate swap agreement. As of September 30, 2008 and 2007, the estimated fair value of the interest rate swap was an unrealized loss of \$(1,404,000) and \$(480,000), respectively.

n. Revenue Recognition, Sales Returns and Allowances

Revenue is recognized at the point of sale for retail store sales, including leased department sales, or when merchandise is shipped to customers for licensed product, Internet and mail order sales. Allowances for returns are recorded as a reduction of revenue, based on the Company's historical experience. Revenues are recorded net of applicable sales taxes.

o. Other Revenues

Included in net sales are revenues earned by the Company through a variety of marketing partnership programs utilizing the Company's opt-in customer database and various in-store marketing initiatives, focused on baby and parent-related products and services.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

p. Cost of Goods Sold

Cost of goods sold in the accompanying Consolidated Statements of Operations includes: merchandise costs (including customs duty expenses), expenses related to inventory shrinkage, product-related corporate expenses (including expenses related to payroll, benefit costs and operating expenses of the Company's buying departments), inventory reserves (including lower of cost or market reserves), inbound freight charges, purchasing and receiving costs, inspection costs, warehousing costs, internal transfer costs, and the other costs of the Company's distribution network.

q. Shipping and Handling Fees and Costs

The Company includes shipping and handling revenue earned from its catalog and e-commerce activities in net sales. Shipping and handling costs, which are included in cost of goods sold in the accompanying Consolidated Statements of Operations, include shipping supplies, related labor costs and third-party shipping costs.

r. Selling, General and Administrative Expenses

Selling, general and administrative expenses in the accompanying Consolidated Statements of Operations includes: advertising and marketing expenses, corporate administrative expenses, store expenses (including store payroll and store occupancy expenses), and store opening expenses.

s. Advertising Costs

The Company expenses the costs of advertising when the advertising occurs. Advertising expenses were \$9,279,000, \$8,887,000 and \$9,908,000 in fiscal 2008, 2007 and 2006, respectively.

t. Store Closing, Asset Impairment and Asset Disposal Expenses

Store closing expenses include lease termination fees, gains or losses on disposal of closed store assets and recognition of unamortized deferred rent. Asset impairment expenses represent losses recognized to reduce the carrying value of impaired long-lived assets. Asset disposal expenses represent gains or losses on disposal of assets other than in connection with store closings, including assets disposed from remodeling or relocation of stores.

u. Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes as prescribed by SFAS No. 109, "Accounting for Income Taxes." Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities as well as from net operating loss carryforwards. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment date.

The Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes" effective as of October 1, 2007. Under FIN No. 48, recognition of a tax benefit occurs when a tax position is more-likely-than-not to be sustained upon examination, based solely on its technical merits. Derecognition of a previously recognized tax position would occur if it is subsequently determined that the tax position no longer meets the more-likely-than-not threshold of being sustained. FIN No. 48 also provided guidance on the

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

measurement of uncertain tax positions. The Company records interest and penalties related to unrecognized tax benefits in income tax provision (benefit).

v. Earnings per Share

Basic earnings per share ("Basic EPS") is computed by dividing net income (loss) by the weighted average number of common shares outstanding, excluding restricted stock awards for which the restrictions have not lapsed. Diluted earnings per share ("Diluted EPS") is computed by dividing net income (loss) by the weighted average number of common shares outstanding, after giving effect to the potential dilution, if applicable, from the assumed lapse of restrictions on restricted stock awards and from the exercise of securities, such as stock options and warrants, into shares of common stock as if those securities were exercised (see Note 12).

The following table summarizes those effects for the diluted earnings per share calculation (in thousands):

	Year Ended September 30,		
	2008	2007	2006
Average number of shares outstanding—Basic	5,924	5,802	5,348
Incremental shares from the assumed lapse of restrictions on restricted stock awards	—	—	—
Incremental shares from the assumed exercise of outstanding stock options	—	—	243
Average number of shares outstanding—Diluted	<u>5,924</u>	<u>5,802</u>	<u>5,591</u>

Stock options totaling 35,030 shares of the Company's common stock were outstanding as of September 30, 2006, but were not included in the computation of diluted earnings per share for fiscal 2006 as their effect would have been antidilutive. Options and restricted stock totaling 1,039,866 and 962,220 shares of the Company's common stock were outstanding as of September 30, 2008 and 2007, respectively, but were not included in the computation of diluted earnings per share for fiscal 2008 and 2007, due to the Company's net loss position. Had the Company reported a profit for fiscal 2008 and 2007, the average number of dilutive shares outstanding would have been approximately 6,048,000 and 6,135,000, respectively.

w. Statements of Cash Flows

In fiscal 2008, 2007 and 2006, the Company paid interest of \$7,169,000, \$10,415,000 and \$14,748,000, respectively, and made income tax payments, net of refunds, of \$552,000, \$(972,000) and \$5,352,000, respectively.

x. Business and Credit Risk

Financial instruments, primarily cash and cash equivalents, investments and accounts receivable, potentially subject the Company to concentrations of credit risk. The Company limits its credit risk associated with cash and cash equivalents and investments by placing such investments in highly liquid funds and instruments. Receivables associated with third-party credit cards are processed by financial institutions, which are monitored for financial stability. The Company is dependent on key suppliers to provide sufficient quantities of inventory at competitive prices. No single supplier represented 10% or more of net purchases in fiscal 2008, 2007 or 2006. A significant majority of the Company's purchases during fiscal 2008, 2007 and 2006 were imported. Management believes that any event causing a disruption of imports from any specific country could be mitigated by moving production to readily available alternative sources.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

y. Insurance

The Company is self-insured for workers' compensation and employee-related health care benefits, up to certain stop-loss limits. Such costs are accrued based on known claims and an estimate of incurred but not reported claims. Further, the Company utilizes a cooperative arrangement with a number of other companies to assist in managing certain insurance risks. The Company's expenses associated with this relationship could be impacted by the loss history associated with the cooperative as a whole. Liabilities associated with these risks are estimated by considering historical claims experience and other actuarial assumptions.

z. Store Preopening Costs

Non-capital expenditures, such as payroll costs incurred prior to the opening of a new store, are charged to expense in the period in which they were incurred.

aa. Reclassifications

Certain reclassifications have been made to the prior year consolidated financial statements to conform to the current year presentation.

bb. New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in U.S. generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial assets and liabilities that are measured at fair value on a recurring basis for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The FASB has issued a one-year deferral of SFAS No. 157's fair value measurement requirements for non-financial assets and liabilities that are not required or permitted to be measured at fair value on a recurring basis. The adoption of SFAS No. 157 for financial assets and liabilities is not expected to have a material impact on the Company's consolidated financial position or results of operations. The impact from adoption of SFAS No. 157 for non-financial assets and liabilities, if any, on the Company's consolidated financial position or results of operations has not yet been determined.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value and requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The adoption of SFAS No. 159 is not expected to have a material impact on the Company's consolidated financial position or results of operations.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133." SFAS No. 161 requires companies to provide qualitative disclosures about the objectives and strategies for using derivatives, quantitative data about the fair value of and gains and losses on derivative contracts, and details of credit-risk-related contingent features in hedged positions. SFAS No. 161 is effective for financial statements issued for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The adoption of SFAS No. 161 is not expected to have a material impact on the Company's consolidated financial position or results of operations.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. INVENTORIES

Inventories as of September 30 were comprised of the following (in thousands):

	<u>2008</u>	<u>2007</u>
Finished goods	\$81,028	\$ 91,860
Work-in-progress	2,904	2,947
Raw materials	4,124	5,678
	<u>\$88,056</u>	<u>\$100,485</u>

4. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment as of September 30 was comprised of the following (in thousands):

	<u>2008</u>	<u>2007</u>
Land	\$ 1,400	\$ 1,400
Building and improvements	13,469	13,009
Furniture and equipment	62,937	61,793
Leasehold improvements	105,657	104,030
	<u>183,463</u>	<u>180,232</u>
Less: accumulated depreciation and amortization	(117,365)	(111,581)
	<u>\$ 66,098</u>	<u>\$ 68,651</u>

Furniture and equipment includes equipment acquired under a capital lease obligation on December 1, 2004. As of September 30, 2008, this equipment had a cost of \$1,107,000 and accumulated amortization of \$830,000. During fiscal 2008, 2007 and 2006, the Company recorded pre-tax charges under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," of \$1,615,000, \$1,776,000 and \$2,578,000, respectively, related to the impairment of leasehold improvements and furniture and equipment at certain of its retail locations.

As of September 30, 2008 and 2007, \$207,000 of assets (not included above) were separately reflected in the accompanying Consolidated Balance Sheets as "Assets held for sale." The Assets held for sale relate to manufacturing and warehouse facilities located in Costa Rica that were acquired and shut down in a fiscal 2002 business purchase. Two of these facilities were previously sold for an aggregate of \$718,000. The remaining facility was sold during the first quarter of fiscal 2009 for approximately \$500,000.

5. RESTRUCTURING AND OTHER CHARGES

On July 1, 2008, the Company announced that it was streamlining its merchandise brands and store nameplates and was implementing cost reductions in order to simplify its business model, reduce overhead costs and improve its merchandise assortments. Pursuant to the strategic restructuring, the Company is rebranding its Mimi Maternity® merchandise brand under its A Pea in the Pod® brand beginning with the Spring 2009 collection, which initially debuted in November 2008. The Company also plans to streamline its store nameplates by January 2009, by renaming its single-brand Mimi Maternity stores as A Pea in the Pod, and by renaming its multi-brand Mimi Maternity stores as Destination Maternity®. In connection with the strategic restructuring the Company also reduced its corporate headcount. The Company incurred pre-tax expense of \$936,000 from its restructuring and cost reduction actions in fiscal 2008, consisting of \$691,000 for cash severance expense and severance-related benefits, and \$245,000 of expense for accelerated depreciation of existing store signs resulting

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. RESTRUCTURING AND OTHER CHARGES (Continued)

from planned store signage changes. Approximately \$128,000 of expense for additional accelerated depreciation is expected to be recorded in the first quarter of fiscal 2009. A summary of the charges incurred and reserves recorded in connection with the restructuring activities during fiscal 2008 is as follows (in thousands):

	Charges Incurred	Payments/ Adjustments	Accrued as of September 30, 2008
Severance and related benefits	\$ 691	\$ (467)	\$ 224
Accelerated depreciation of store signage	245	(245)(1)	—
Total	<u>\$ 936</u>	<u>\$ (712)</u>	<u>\$ 224</u>

(1) Adjustment to reduce net book value of associated property, plant and equipment

In connection with the retirement of the Company's former Chief Executive Officer, the Company recognized pre-tax expense of \$2,525,000 in the fourth quarter of fiscal 2008, included in restructuring and other charges in the accompanying Consolidated Statements of Operations. The charge reflects benefit costs and payroll taxes related to an amendment to the executive's supplemental retirement agreement with the Company (see Notes 15 and 16).

6. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

As of September 30, accrued expenses and other current liabilities were comprised of the following (in thousands):

	2008	2007
Employee compensation and benefits	\$10,596	\$11,106
Income taxes payable	—	1,768
Interest	1,012	1,562
Deferred rent	4,302	4,014
Sales taxes	2,627	3,561
Insurance	835	1,664
Audit and legal	1,464	4,814
Accrued store construction costs	760	442
Gift certificates and store credits	4,960	4,591
futuretrust® college savings program	1,811	2,255
Supplemental executive retirement plan benefits	1,560	—
Other	7,879	5,856
	<u>\$37,806</u>	<u>\$41,633</u>

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DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. DEFERRED RENT AND OTHER NON-CURRENT LIABILITIES

As of September 30, deferred rent and other non-current liabilities were comprised of the following (in thousands):

	<u>2008</u>	<u>2007</u>
Deferred rent	\$25,611	\$24,798
Less: current portion included in accrued expenses and other current liabilities	(4,302)	(4,014)
Non-current deferred rent	21,309	20,784
Supplemental executive retirement plan benefits	4,323	2,957
Accrued state income taxes	2,166	—
Interest rate swap	1,404	480
Other	189	23
	<u>\$29,391</u>	<u>\$24,244</u>

8. LINE OF CREDIT

The Company has a \$65,000,000 senior secured revolving credit facility (the "Credit Facility"). On March 13, 2007, in connection with the refinancing of its senior long-term debt, the Company amended the Credit Facility in order to permit the refinancing transaction (see Note 9). This amendment of the Credit Facility also extended its maturity from October 15, 2009 to March 13, 2012, increased its size from \$60,000,000 to \$65,000,000, and reduced the LIBOR-based interest rate option under the facility by 0.25%. Upon the Company's request and with the consent of the lender, permitted borrowings under the Credit Facility may be increased up to an additional \$20,000,000, in increments of \$2,500,000, up to a maximum limit of \$85,000,000. Proceeds from advances under the Credit Facility, with certain restrictions, may be used to provide financing for working capital, letters of credit, capital expenditures, debt prepayments, dividends, share repurchases and other general corporate purposes. The Company paid certain closing fees in connection with the negotiation and execution of the Credit Facility, as amended. The Company also pays an unused line fee under the Credit Facility and certain early termination fees would be owed if the Credit Facility is terminated prior to March 13, 2009.

The Credit Facility contains various affirmative and negative covenants and representations and warranties. There are no financial covenant requirements under the Credit Facility unless Excess Availability (as defined in the agreement) falls below 10% of the Borrowing Base (as defined in the agreement) in which case the Company would be required to meet a certain minimum fixed charge coverage ratio (which increases from 1.00x to 1.10x during the term of the Credit Facility). During all of fiscal 2008, 2007 and 2006, the Company exceeded the then applicable excess availability requirements under the then effective Credit Facility and was not subject to any financial covenants. The Credit Facility is secured by a security interest in the Company's accounts receivable, inventory, real estate interests, letter of credit rights, cash, intangibles and certain other assets. The security interest granted to the Credit Facility Lender is, in certain respects, subordinate to the security interest granted to the Term Lenders. The interest rate on outstanding borrowings is equal to, at the Company's election, either the lender's prime rate or the lender's LIBOR rate plus the applicable margin. The applicable margin for LIBOR rate borrowings is variable, ranging from 1.00% to 1.50%, based upon the availability calculation made in accordance with the Credit Facility. The applicable margin for LIBOR rate borrowings, based upon the availability calculation made in accordance with the agreement, has been the lowest available margin since the inception of the Credit Facility.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. LINE OF CREDIT (Continued)

Any amounts outstanding under the Credit Facility may be accelerated and become due and payable immediately and all loan and letter of credit commitments thereunder may be terminated upon an event of default and expiration of any applicable cure period. Events of default include: (i) nonpayment of obligations due under the Credit Facility, (ii) failure to perform any covenant or agreement contained in the Credit Facility, (iii) material misrepresentations, (iv) failure to pay, or certain other defaults under, other material indebtedness of the Company, (v) certain bankruptcy or insolvency events, (vi) a change of control, (vii) material uninsured losses, (viii) indictments of the Company or senior management in a material forfeiture action, and (ix) customary ERISA defaults, among others.

As of September 30, 2008, the Company had no outstanding borrowings under the Credit Facility and \$10,605,000 in letters of credit, with \$45,870,000 of availability under the credit line based on Borrowing Base limitations, compared to no outstanding borrowings and \$7,019,000 in letters of credit, with \$57,981,000 of availability under the credit line as of September 30, 2007. Borrowings under the Credit Facility as of September 30, 2008 would have borne interest at a rate of between approximately 4.93% and 5.00% per annum. During fiscal 2008 and 2007, the Company's average level of direct borrowings under the Credit Facility was \$5,162,000 and \$1,040,000, respectively.

9. LONG-TERM DEBT

The following table summarizes the Company's long-term debt as of September 30 (in thousands):

	2008	2007
Senior secured Term Loan B, interest is variable (5.41% as of September 30, 2008; effective rate of 7.09% including effect of interest rate swap), principal of \$225 due quarterly through December 31, 2012 with the remaining balance due March 13, 2013	\$75,650	\$89,775
Industrial Revenue Bond, interest is variable (4.28% as of September 30, 2008), principal due annually until September 1, 2020 (collateralized in full by a standby letter of credit)	2,516	2,665
<i>Government Mortgage Notes:</i>		
Interest at 3.0%, principal due monthly until May 1, 2011 (collateralized by a second mortgage on certain property and equipment at the Company's headquarters)	424	575
Interest at 2.0%, principal due monthly until March 1, 2011 (collateralized by certain equipment at the Company's headquarters)	56	78
<i>Capital Lease Obligation:</i>		
Equipment lease, interest at 6.75%, payments due monthly until November 30, 2007 (collateralized by certain equipment at the Company's headquarters)	—	87
	78,646	93,180
Less: current portion	(1,860)	(1,534)
	<u>\$76,786</u>	<u>\$91,646</u>

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. LONG-TERM DEBT (Continued)

Long-term debt maturities as of September 30, 2008 are as follows (in thousands):

<u>Fiscal Year</u>		
2009	\$	1,860
2010		1,247
2011		1,196
2012		1,085
2013		71,618
2014 and thereafter		1,640
		<u>\$78,646</u>

In August 2006, the Company's Board of Directors authorized the repurchase of up to \$10.0 million principal amount of the Company's 11^{1/4}% senior notes (the "Senior Notes"). During August and September 2006, the Company completed the repurchase of the authorized amount in two transactions at an aggregate of 105.832% of the \$10.0 million principal amount, plus accrued and unpaid interest. In connection with the August and September 2006 repurchases, the Company recorded pre-tax charges totaling \$873,000, representing the premium paid plus the write-off of unamortized debt issuance discount and deferred financing costs.

In November 2006, the Company's Board of Directors authorized the repurchase of \$25,000,000 principal amount of the Senior Notes. On December 8, 2006, the Company completed the repurchase of the authorized amount at 105.625% of the \$25,000,000 principal amount, plus accrued and unpaid interest. In connection with the December 2006 repurchase, the Company recorded a pre-tax charge totaling \$2,093,000, representing the premium paid of \$1,406,000 plus the write-off of unamortized debt issuance discount and deferred financing costs of \$687,000. On April 18, 2007, the Company completed the redemption of the remaining outstanding amount of its Senior Notes at 105.625% of the \$90,000,000 principal amount, plus accrued and unpaid interest. In connection with the April 2007 redemption, the Company recorded a pre-tax charge totaling \$7,330,000, representing the premium paid of \$5,063,000 plus the write-off of unamortized debt issuance discount and deferred financing costs of \$2,267,000.

On March 13, 2007, the Company entered into a Term Loan and Security Agreement (the "Term Loan Agreement") for a \$90,000,000 senior secured Term Loan B due March 13, 2013 (the "Term Loan"), the proceeds of which were received on April 18, 2007 and were used to redeem the remaining \$90,000,000 principal amount of the Senior Notes. The interest rate on the Term Loan is equal to, at the Company's election, either (i) the prime rate plus 1.00%, or (ii) the LIBOR rate plus the applicable margin. The applicable margin was initially fixed at 2.50% through and including the fiscal quarter ending September 30, 2007. Thereafter, the applicable margin for LIBOR rate borrowings is either 2.25% or 2.50%, depending on the Company's Consolidated Leverage Ratio (as defined). Based upon the Company's applicable quarterly Consolidated Leverage Ratio during fiscal 2008, the applicable margin for LIBOR rate borrowings remained at 2.50% for fiscal 2008. The Company is required to make minimum repayments of the principal amount of the Term Loan in quarterly installments of \$225,000 each. The Company is also required to make an annual principal repayment equal to 25% or 50% of Excess Cash Flow (as defined) in excess of \$5,000,000 for each fiscal year, with the 25% or 50% factor depending on the Company's Consolidated Leverage Ratio. The required principal repayment for fiscal 2008, which was calculated based on the 50% factor, is \$622,000, is due

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. LONG-TERM DEBT (Continued)

in December 2008, and is reflected in "Current portion of long-term debt" in the accompanying Consolidated Balance Sheet. Additionally, the Term Loan can be prepaid at the Company's option, in part or in whole, at any time without any prepayment premium or penalty. During fiscal 2008, the Company prepaid \$13,000,000 of the outstanding Term Loan. At September 30, 2008, the Company's indebtedness under the Term Loan Agreement was \$75,650,000.

The Term Loan is secured by a security interest in the Company's accounts receivable, inventory, real estate interests, letter of credit rights, cash, intangibles and certain other assets. The security interest granted to the Term Lenders is, in certain respects, subordinate to the security interest granted to the Credit Facility Lender. The Term Loan Agreement imposes certain restrictions on the Company's ability to, among other things, incur additional indebtedness, pay dividends, repurchase stock, and enter into other various types of transactions. The Term Loan Agreement also contains quarterly financial covenants that require the Company to maintain a specified maximum permitted Consolidated Leverage Ratio and a specified minimum permitted Consolidated Interest Coverage Ratio (as defined). Since the inception of the Term Loan, the Company has been in compliance with the financial covenants of its Term Loan Agreement. Any amounts outstanding under the Term Loan may be accelerated and become due and payable immediately upon an event of default and expiration of any applicable cure period. Events of default include: (i) nonpayment of obligations due under the Term Loan, (ii) failure to perform any covenant or agreement contained in the Term Loan, (iii) material misrepresentations, (iv) failure to pay, or certain other defaults under, other material indebtedness of the Company, (v) certain bankruptcy or insolvency events, (vi) a change of control, (vii) material uninsured losses, (viii) indictments of the Company or senior management in a material forfeiture action, and (ix) customary ERISA defaults, among others.

In order to mitigate the Company's floating rate interest risk on the variable rate Term Loan, the Company entered into an interest rate swap agreement with the Agent bank for the Term Loan that commenced on April 18, 2007, the date the \$90,000,000 Term Loan proceeds were received, and expires on April 18, 2012. The interest rate swap agreement enables the Company to effectively convert an amount of the Term Loan equal to the notional amount of the interest rate swap from a floating interest rate of LIBOR plus 2.50% (subject to reduction to LIBOR plus 2.25% if the Company achieves a specified leverage ratio), to a fixed interest rate of 7.50% (subject to reduction to 7.25% if the Company achieves a specified leverage ratio) for the significant majority of the Term Loan. The notional amount of the interest rate swap was \$75,000,000 at the inception of the swap agreement and decreases over time to a notional amount of \$5,000,000 at the expiration date. The notional amount of the swap was \$57,500,000 as of September 30, 2008 and over the next eighteen months decreases as follows: to \$50,000,000 starting October 20, 2008; to \$42,500,000 starting April 20, 2009; and to \$35,000,000 starting October 19, 2009. As of September 30, 2008 and 2007, the estimated fair value of the interest rate swap was an unrealized loss of \$(1,404,000) and \$(480,000), respectively, which were included in deferred rent and other non-current liabilities in the accompanying Consolidated Balance Sheets. During the years ended September 30, 2008 and 2007, pre-tax (loss) gain of \$(720,000) and \$121,000, respectively, associated with the exchange of interest rate payments under the swap agreement were included as interest expense. The Company expects to reclassify \$(848,000) of pre-tax unrealized loss from accumulated other comprehensive loss into interest expense in fiscal 2009.

In connection with the issuance of the Term Loan and the amendment of the Credit Facility (see Note 8), the Company incurred deferred financing costs of \$1,086,000. These deferred financing costs are being amortized and included in interest expense over the term of the related debt agreement.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. COMMON AND PREFERRED STOCK

On July 29, 2008, the Company announced that its Board of Directors approved a program to repurchase up to \$7,000,000 of the Company's outstanding common stock. Under the program, the Company may repurchase shares from time to time through solicited or unsolicited transactions in the open market or in negotiated or other transactions. The program will be in effect until the end of July 2010. There were no repurchases of common stock under the program during fiscal 2008.

The Company has authorization to issue up to 2,000,000 shares of preferred stock, par value \$0.01 with 300,000 shares authorized Series B Junior Participating Preferred Stock ("Series B Preferred Stock"). There was no preferred stock issued or outstanding as of September 30, 2008 or 2007.

The Series B Preferred Stock can be purchased in units equal to one one-thousandth of a share (the "Series B Units") under the terms of the Rights Agreement (see Note 11). The holders of the Series B Units are entitled to receive dividends when and if declared on common stock. Series B Units are junior to the common stock for both dividends and liquidations. Each Series B Unit votes as one share of common stock.

11. RIGHTS AGREEMENT

On October 9, 2005, the Company entered into an Amended and Restated Rights Agreement to renew its then existing Rights Agreement (collectively referred to as the "Rights Agreement") that would otherwise have expired on October 9, 2005. Under the Rights Agreement, the Company provided and will provide one Right (the "Right") for each share of Destination Maternity Corporation common stock now or hereafter outstanding. Under certain limited conditions, as defined in the Rights Agreement, each Right entitles the registered holder to purchase from the Company one Series B Unit at \$85 per share, subject to adjustment. The Rights expire on October 9, 2015 (the "Final Expiration Date").

The Rights Agreement provides the independent directors of the Company with some discretion in determining when the Distribution Date (as defined in the Rights Agreement) shall occur and the date until which the Rights may be redeemed. In addition, the Rights Agreement exempts from its operation any person that acquires, obtains the right to acquire, or otherwise obtains beneficial ownership of 15.0% or more of the then outstanding shares of the Company's common stock (an "Acquiring Person") without any intention of changing or influencing control of the Company provided that such person, as promptly as practicable, divests himself or itself of a sufficient number of shares of common stock so that such person would no longer be an Acquiring Person.

The Rights are not exercisable until the Distribution Date, which will occur upon the earlier of (i) ten business days following a public announcement that an Acquiring Person has acquired beneficial ownership of 15.0% or more of the Company's outstanding common stock, and ten business days following the commencement of a tender offer or exchange offer that would result in a person or group owning 15.0% or more of the Company's outstanding common stock, or (ii) such later date as may be determined by action of a majority of the independent directors. The Rights have certain anti-takeover effects. The Rights will cause substantial dilution to a person or group that attempts to acquire the Company without conditioning the offer on the redemption of the Rights.

The Rights can be mandatorily redeemed by action of a majority of the independent directors at any time prior to the earlier of the Final Expiration Date and the Distribution Date for \$0.01 per Right. Upon exercise and the occurrence of certain events, as defined in the Rights Agreement, each

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. RIGHTS AGREEMENT (Continued)

holder of a Right, except the Acquiring Person, will have the right to receive Series B Units, or common stock of the acquiring company, in each case having a value equal to two times the exercise price of the Right.

12. EQUITY AWARD PLANS AND WARRANTS

The Company has three equity award plans: the Director Stock Option Plan (the "Director Plan"), the Amended and Restated 1987 Stock Option Plan (the "1987 Plan") and the 2005 Equity Incentive Plan (the "2005 Plan"). The Director Plan expired on December 31, 2004 and no further awards may be granted under the Director Plan. The 1987 Plan expired on December 9, 2007, and no further awards may be issued under the 1987 Plan. Options issued under the Director Plan and the 1987 Plan will remain outstanding until they have expired, been exercised or have otherwise terminated. Up to a total of 2,175,000 options were able to be issued under the 1987 Plan and the Director Plan (including up to a total of 200,000 options which were issuable under the Director Plan). In January 2006, the stockholders of the Company approved the adoption of the 2005 Plan. Under the 2005 Plan, employees, directors, consultants and other individuals who provide services to the Company, may be granted awards in the form of options, stock appreciation rights, restricted stock or restricted stock units. Up to 500,000 shares of the Company's common stock may be issued in respect of awards under the 2005 Plan, with no more than 250,000 of those shares permitted to be issued in respect of restricted stock or restricted stock units granted under the 2005 Plan, and awards of options to purchase the Company's common stock will have exercise prices as determined by the Compensation Committee of the Board of Directors that are no lower than the fair market value of the stock on the date of grant.

No options have been granted by the Company with an exercise price less than the fair market value of the Company's common stock on the date of grant for any of the periods presented. The majority of the options issued under the plans vest ratably over a five-year period, although some options vest immediately, and options issued under the plans generally expire ten years from the date of grant. Restricted stock awards issued under the 2005 Plan have restrictions that lapse ratably over periods ranging from one to five years. On December 13, 2006, the Board of Directors modified the compensation structure for its non-employee directors and, effective January 19, 2007, each outside director will be granted 2,000 shares of restricted stock on an annual basis that will vest one year from the date of grant. The Company issues new shares upon exercise of vested options. As of September 30, 2008, there were 113,239 shares of the Company's common stock available for grant under the 2005 Plan, with no more than 88,239 of those shares permitted to be issued in respect of restricted stock or restricted stock units granted under the 2005 Plan.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. EQUITY AWARD PLANS AND WARRANTS (Continued)

Stock option activity for all plans was as follows:

	Outstanding Options (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Life (years)	Aggregate Intrinsic Value (in thousands)
Balance—September 30, 2007	841	\$ 13.23		
Granted	200	13.74		
Exercised	(74)	9.37		
Forfeited	(29)	19.30		
Expired	(15)	20.33		
Balance—September 30, 2008	923	13.34	6.1	\$ 1,824
Exercisable—September 30, 2008	530	\$ 13.04	4.4	\$ 1,399

As of September 30, 2008, \$4,974,000 of total unrecognized compensation cost related to non-vested awards is expected to be recognized over a weighted-average period of 1.8 years. During the years ended September 30, 2008, 2007 and 2006, the total intrinsic value of options exercised was \$469,000, \$6,517,000 and \$5,085,000, respectively. The total cash received from these option exercises was \$692,000, \$3,737,000 and \$4,913,000, respectively, and the actual tax benefit realized for the tax deductions from these option exercises was \$175,000, \$2,541,000 and \$1,983,000, respectively. During fiscal 2007, \$1,422,000 of compensation cost recognized in fiscal 2006 and recorded as a liability was reclassified to additional paid-in capital in conjunction with a modification of the original award.

On September 26, 2008, the Company granted to an executive officer two stock options, each to purchase 100,000 shares of common stock, under the 2005 Plan (see Note 15). The first stock option vests ratably over a five-year period. The second stock option vests ratably over a five-year period and is subject to the further condition that, on or before the fifth anniversary of the grant date, the closing price for a share of the Company's common stock shall have exceeded \$30.00 for a period of 30 consecutive trading days.

The weighted average fair value of stock options granted during fiscal 2008 and 2006 was estimated to be \$7.50 and \$8.60 per option share, respectively. No options were granted during fiscal 2007. The weighted average fair value of each option granted is calculated on the date of grant using the Black-Scholes option-pricing model for most option grants and a Monte Carlo Simulation option-pricing model for the fiscal 2008 grant that included a market condition. Weighted-average assumptions for option grants were as follows:

	Year Ended September 30,		
	2008	2007	2006
Dividend yield	none	—	none
Expected price volatility	57 %	—	58 %
Risk-free interest rates	3.0 %	—	4.5 %
Expected lives	6.6 years	—	6.4 years

Expected volatility was determined using a weighted average of the historic volatility of the Company's common stock as of the option grant date measured over a period equal to the expected life of the grant. Risk-free interest rates were based on the U. S. Treasury yield curve in effect at the

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. EQUITY AWARD PLANS AND WARRANTS (Continued)

date of the grant. Expected lives were determined using the simplified method, which measures the average of the option vesting term and the option contractual term.

The following table summarizes information about stock options outstanding as of September 30, 2008:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding (in thousands)	Weighted Average Remaining Life	Weighted Average Exercise Price	Number Exercisable (in thousands)	Weighted Average Exercise Price
\$ 7.40 to \$ 8.00	33	3.1	\$ 7.70	33	\$ 7.70
8.01 to 9.00	54	0.3	9.00	54	9.00
9.01 to 10.00	121	2.0	9.50	121	9.50
10.01 to 12.00	145	6.8	10.05	62	10.09
12.01 to 13.00	233	6.2	12.84	162	12.85
13.01 to 14.00	216	9.7	13.74	15	13.72
14.01 to 23.00	39	6.7	17.59	18	16.86
23.01 to 24.00	26	5.1	23.62	26	23.62
24.01 to 37.05	56	6.2	30.31	39	30.37
\$ 7.40 to \$37.05	<u>923</u>	6.1	\$ 13.34	<u>530</u>	\$ 13.04

Restricted stock activity for the 2005 Plan was as follows:

	Outstanding Shares (in thousands)	Weighted Average Grant Date Fair Value
Nonvested—September 30, 2007	121	\$ 46.04
Granted	53	15.51
Vested	(45)	45.77
Forfeited	(12)	40.31
Nonvested—September 30, 2008	<u>117</u>	\$ 32.98

13. INCOME TAXES

For the years ended September 30, the income tax provision (benefit) was comprised of the following (in thousands):

	2008	2007	2006
Current provision	\$ 359	\$ 2,898	\$5,104
Deferred provision (benefit)	(969)	(3,067)	715
	<u>\$ (610)</u>	<u>\$ (169)</u>	<u>\$5,819</u>
Federal provision (benefit)	\$(1,062)	\$ (275)	\$4,988
State provision	452	106	831
	<u>\$ (610)</u>	<u>\$ (169)</u>	<u>\$5,819</u>

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. INCOME TAXES (Continued)

The reconciliations of the statutory federal rate to the Company's effective income tax rates for the years ended September 30 were as follows:

	2008	2007	2006
Statutory federal tax rate	(34.0)%	(34.0)%	35.0%
State taxes, net of federal benefit	7.9	15.9	4.0
FIN No. 48 provision, net of federal benefit	6.3	—	—
Other	(10.7)	(12.0)	—
	<u>(30.5)%</u>	<u>(30.1)%</u>	<u>39.0%</u>

The deferred tax effects of temporary differences giving rise to the Company's net deferred tax assets as of September 30 were as follows (in thousands):

	2008	2007
<i>Deferred tax assets:</i>		
Net operating loss carryforwards	\$ 2,076	\$ 1,273
Tax credit carryforwards	472	—
Depreciation	3,012	3,836
Deferred rent	9,558	9,250
Inventory reserves	903	995
Employee benefit accruals	1,750	2,122
Pension benefits	2,196	1,103
Stock-based compensation	1,442	1,653
Other accruals	1,243	1,415
Other	1,736	1,465
	<u>24,388</u>	<u>23,112</u>
<i>Deferred tax liability:</i>		
Prepaid expenses	(823)	(800)
	<u>\$23,565</u>	<u>\$22,312</u>

As of September 30, 2008, the Company has net operating loss carryforwards for federal tax purposes of \$5,932,000, of which \$3,640,000 were acquired in a fiscal 2002 business acquisition and are subject to annual deduction limitations due to the change in ownership. The net operating loss carryforwards begin to expire in 2021. The Company does not expect the limitations on the acquired net operating loss carryforwards to reduce its ability to ultimately use such carryforwards. The tax benefit of the acquired net operating loss carryforwards was recorded under the purchase method of accounting.

No valuation allowance has been provided for the net deferred tax assets. Based on the Company's historical levels of taxable income, management believes it is more likely than not that the Company will realize the net deferred tax assets as of September 30, 2008. There can be no assurance that the Company will generate taxable earnings or any specific level of earnings in the future.

As of September 30, 2005, management determined that the deferred tax assets should reflect the state tax benefits for several of the states in which the Company is operating. This determination was